

**Entered on Docket
December 30, 2020**
**EDWARD J. EMMONS, CLERK
U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA**



**The following constitutes the order of the Court.
Signed: December 30, 2020**

**M. Elaine Hammond
U.S. Bankruptcy Judge**

**UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA**

ORDER DENYING ARCH+BEAM's APPLICATION FOR COMPENSATION

Home Loan Center (“HLC”) was a non-operating entity with scheduled assets of \$11 million and scheduled liabilities of \$111 million at the time of its filing. HLC’s largest asset was scheduled in an unknown amount—a litigation claim for recovery of \$40 million in dividends paid to its parent corporation, Lending Tree, LLC (“Lending Tree”) in January 2016.

On June 21, 2019, the United States District Court for District of Minnesota entered judgment for ResCap Liquidating Trust (“ResCap”) against HLC in the amount of \$68 million. Lacking assets to post a supersedeas bond, HLC filed its Chapter 11 case on July 21, 2019.¹ Shortly thereafter, it filed applications to employ three professional groups: counsel for the debtor-in-possession, special counsel for the DIP, and Arch + Beam Global, LLC

¹ Professionals were paid in full prior and provided significant retainers to the filing of the petition.

1 (“A+B”) for advisory services with Matthew English as Chief Restructuring Officer. The law
2 firm applications were brought pursuant to § 327, but A+B’s was brought pursuant to the “Jay
3 Alix Protocol” (“Protocol”), applying 11 U.S.C. §§ 105 and 363.²

4 On the same day as these applications were filed, ResCap moved to convert the case to
5 Chapter 7. This led to discovery and a stipulation between the parties to continue the hearing
6 on the motion to convert, employment applications, and other initial motions to August 29,
7 2019. During this period, HLC and its professionals sought to negotiate a settlement with
8 Lending Tree that would fund a liquidating plan providing recovery to HLC’s creditors. HLC
9 succeeded in obtaining a significant offer from Lending Tree, but due to concerns about an
10 insider relationship and the lack of a term sheet, ResCap and Lehman Brothers Holdings, Inc.
11 (“Lehman”), the second largest unsecured creditor, did not support this proposed settlement.
12 Without a path forward in Chapter 11, HLC’s counsel announced at the August 29 hearing
13 that HLC would voluntarily convert its case to Chapter 7.

14 That day, HLC’s counsel filed a notice of conversion, and the matters set for hearing
15 were continued to September 24, 2019. A motion to convert was filed promptly after HLC’s
16 counsel was advised that it was required. The conversion order was entered on September 19,
17 2019, at which point Doris Kaelin was appointed Chapter 7 Trustee (“Trustee”).

18 Prior to the hearing on employment applications, the United States Trustee (“UST”)
19 and creditors ResCap and Lehman filed oppositions to the A+B application. The UST
20 opposed use of the Protocol where there was no intent to reorganize or liquidate as a going
21 concern, as evidenced by the fact that Debtor was in the process of converting to Chapter 7.
22 ResCap and Lehman jointly filed a similar objection and requested that the unearned retainer
23 held by A+B be turned over to the Chapter 7 Trustee. At the time of the hearing, HLC had
24 been converted to Chapter 7 and there was no longer a debtor-in-possession to support A+B’s
25 application. I declined to extend the Protocol to authorize professional retention following
26 conversion of the case to Chapter 7, and entered an order denying A+B’s employment

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² 11 U.S.C. §§ 101 *et seq.* referred to herein as the “Bankruptcy Code” or by section number.

1 application without prejudice to A+B seeking employment pursuant to Bankruptcy Code
2 § 327. (Doc #101) The order was not appealed and is law of the case.

3 HLC filed a second application to employ A+B for advisory services and Matthew
4 English as corporate officer. (Doc #123) As admitted in the application, English was the sole
5 prepetition director of HLC and as such did not satisfy the disinterestedness requirement. The
6 Trustee and UST raised informal objections, and A+B withdrew the application. (Doc #126)

7 At the suggestion of HLC's counsel, counsel for the key parties in this case entered
8 into a stipulation authorizing A+B to seek compensation as an administrative expense
9 pursuant to § 507(a)(2), provided that A+B file a fee application in accordance with § 330 and
10 have its compensation governed by the standards set forth in § 330. (Doc # 129) This
11 stipulation was without prejudice to or waiver of the right of any party in interest to object to
12 any application. An order approving the stipulation was entered (Doc # 131) and A+B then
13 filed an application for compensation consistent with § 330 (Doc # 147, 148). Ten months
14 later, Trustee objected to A+B's request for an administrative claim for its work during the
15 period HLC was a debtor-in-possession. Trustee asserts that there is no legal authority to
16 support A+B's request.

17 While recognizing that the stipulation did not include a waiver, A+B asserts that it
18 anticipated an objection to specific fees, not an objection to the entirety of the claim or A+B's
19 ability to obtain an administrative claim. It argues that had it realized this could be Trustee's
20 position, it would have pursued its application. But as A+B withdrew its application a month
21 before the stipulation was signed, the decision to withdraw the application was independently
22 made prior to entry into the stipulation.

23 A+B's application was set for hearing on November 19, 2020.

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25 Analysis

26 Trustee's objection to A+B's application is straightforward. There is no statutory
27 provision or case authority to allow A+B an administrative claim. Neither A+B nor HLC's
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1 Chapter 11 counsel provided any argument to the contrary. Instead, A+B relies on the
2 inequities of the situation and encourages the use of judicial discretion to resolve the issue.

3 If A+B is not allowed an administrative claim, it will be the only professional not
4 compensated for its work during this case. In her objection, Trustee acknowledges that A+B
5 performed work for HLC while it was a debtor-in-possession and assisted with an orderly
6 transition from Chapter 11 to 7. Further, Trustee received compensation in this case that may
7 be the largest award issued pursuant § 326(a) in this District. This is not a case where
8 reduction of professional compensation is a shared burden.

9 Yet A+B may only be allowed compensation in a manner that is consistent with the
10 Bankruptcy Code. Section 507(a)(2) authorizes administrative expense status for claims
11 allowed pursuant to § 503(b). There are two statutory grounds to be considered, plus judicial
12 discretion as advocated at the hearing.

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14 (1) Section 503(b)(2)

15 Section 503(b)(2) provides an allowed, administrative expense for compensation and
16 reimbursement awarded under § 330(a) of the Code. This provision ensures that professionals
17 retained by or on behalf of the estate have one of the highest priorities of distribution. The
18 trade-off for this administrative priority is that the professional must meet the requirements of
19 § 327, including that the professional “does not hold or represent an interest adverse to the
20 estate, and that are disinterested persons.” A+B recognizes that while it does not hold an
21 interest adverse to the estate, English was HLC’s sole officer prior to the bankruptcy filing
22 and is not disinterested.

23 For this reason, A+B sought employment pursuant to the Protocol. While predicated
24 on § 101 and § 363 rather than § 327(a), there is no statutory authority for the Protocol.
25 Instead, it arose out of a settlement agreement between the UST and Jay Alix & Associates in
26 matters involving a significant disgorgement of funds by Jay Alix. The key contours are:

27 (a) individuals associated with management consultancy firms or similar
28 entities will be retained in only one capacity,

(b) the retention application must be filed under Bankruptcy Code § 363 and disclose the firm’s relationship with interested parties and provide other disclosures otherwise indicating it is disinterested,
(c) monthly staffing reports must be filed and are subject to Court review; and
(d) retention of individuals provided by the firm must be approved by and act under the direction of an independent board of directors.³

“[T]he Protocol was designed to prevent a party from using its position in one capacity to benefit itself in another capacity.” *In re Nine West Holdings, Inc.*, 588 B.R. 678, 688 (Bankr S.D.N.Y. 2018).

The Protocol consists of a four-page outline and does not directly address how “crisis management professionals” will be compensated. A+B’s initial application contemplated receiving immediate payment of its invoices from HLC’s funds held as a retainer. This is consistent with authorizing use of estate assets outside the ordinary course of business after notice and hearing but does not allow for an administrative claim. Section 503(b) does not include either §§ 105 or 363(b) as a statutory basis for an administrative claim.

(2) Section 503(b)(1)

Section 503(b)(1) authorizes an administrative claim for “the actual, necessary costs and expenses of preserving the estate.” The Ninth Circuit set forth the parameters of this section in *In re Dant & Russell, Inc.*, 853 F. 2d 700 (9th Cir. 1988). Review and application of the guidelines illustrates the hurdles that English and A+B must overcome:

(a) Section 503(b)(1) is to be narrowly construed to keep fees and administrative costs at a minimum. *Id.* at 706.

The narrow construction of professional fees was further addressed by the BAP in *In re Weibel*, 176 B.R. 209 (9th Cir. BAP 1994). There, the court found that § 503(b)(1) and (b)(2) are remarkably similar, each providing an administrative claim for the “actual,

³ See *United States Trustee Program Policy and Practices Manual*, available at <https://www.justice.gov/ust/united-states-trustee-program-policy-and-practices-manual>

1 necessary” services to or costs and expenses used to preserve the estate. *Id.* at 213. As such,
2 the court found it reasonable “to construe § 503(b)(2), with its specific reference to
3 compensation for professionals under Section 330, as the only part of Section 503(b) under
4 which professionals can receive compensation.” *Id.*

5 (b) An actual, not potential benefit, must accrue to the estate, and courts should be
6 more concerned with maximizing the size of the estate for creditors. *Dant & Russell*,
7 853 F. 2d at 706.

8 Here, resolution of the issue determines whether A+B is authorized to apply its
9 retainer to its fees and expenses, or whether those funds are turned over to the Trustee for
10 distribution to creditors.

11 (c) Preservation of estate assets for the benefit of creditors. *Id.* at 706-07.

12 From the outset, HLC’s primary asset was its claim against Lending Tree for recovery
13 of the dividend. The estate was not in significant danger of losing this asset, but rather trying
14 to determine the most efficient means of converting it from a potential recovery to funds
15 available for distribution to creditors. It appears that A+B’s work during the Chapter 11
16 period was beneficial to HLC, and it may have laid the groundwork for the ultimate
17 resolution. But it was not directly successful in resolving the dispute and recovering funds for
18 creditors.

19 (d) Courts are not free to establish their own priorities of payment within the
20 Bankruptcy Code. *Id.* at 709.

21 Sections 507(a)(2) and 503 were enacted by Congress and encapsulate the universe of
22 administrative claims. “[W]hile there can be some administrative expenses that are not listed
23 in § 503(b), they must nonetheless fall within § 503(b)’s interstices.” *In re Lehman Bros.*
24 *Holdings Inc.*, 508 B.R. 283, 289 (S.D.N.Y. 2014).

25 A+B’s argument for application of § 503(b)(1) is precluded by case authority within
26 the Ninth Circuit holding that § 503(b)(1) does not provide an alternate means for
27 professionals that do not satisfy the requirements of § 327 to obtain an administrative claim.
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1 See *Weibel*, 176 B.R. at 213.⁴ While there is authority for a retroactive award of fees for
2 services rendered by a professional without court approval, these cases still require the
3 professional to be disinterested. A requirement English cannot meet. See *In re Atkins*, 69 F.
4 3d 970, 976 (9th Cir 1995) (“exceptional circumstances” authorizing *nunc pro tunc*
5 employment for compensation requires professional to satisfy requirements for employment
6 in § 327); *In re Mehdipour*, 202 B.R. 474, 479 (9th Cir. BAP 1996) (finding that
7 compensation under § 503(b)(1) requires the professional to be disinterested and not hold any
8 adverse interests).

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10 (3) Judicial Discretion

11 Judicial discretion is then the avenue of last resort for A+B. A court’s discretion is not
12 subject to clearly defined boundaries but requires the use of cautious restraint in order to
13 avoid favoritism. It is more readily applied in administrative and procedural matters than to
14 substantive questions. And as the Supreme Court made clear in *Law v. Siegel*, 571 U.S. 415,
15 421 (2014), a bankruptcy court’s exercise of its statutory and inherent power “may not
16 contravene specific statutory provisions.” Section 105(a) “confers authority to ‘carryout’ the
17 provisions of the Code, but it is quite impossible to do that by taking action that the Code
18 prohibits.” *Id.* “[W]hatever equitable powers remain in the bankruptcy courts must and can
19 only be exercised within the confines’ of the Bankruptcy Code.” *Id.* at 422 (quoting *Norwest
Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988)).

20 Allowance of professional employment and compensation is addressed in five sections
21 of the Bankruptcy Code – §§ 327, 328, 329, 330, and 331. Allowance of an administrative
22 claim for professional compensation awarded under § 330(a) is provided in §503(b)(2).
23 Professional employment and compensation is well-framed by the Bankruptcy Code and
24 substantive in nature. As such, my judicial discretion is limited where the professional does
25 not satisfy the statutory requirements for employment. The Protocol addressed the issue of

26 ⁴ The Second and Third Circuits agree. See *In re Keren Ltd. Partnership*, 189 F. 3d 86 (2d Cir
27 1999); *In re F/S Airlease II, Inc.*, 844 F. 2d 99 (3d Cir. 1988).

1 employment of professionals that do not satisfy § 327(a)'s requirements, but it is not so fully
2 formed as to address the issue originally presented here: an intervening conversion to Chapter
3 7 resulting in denial of employment. And as the Protocol is incapable of creating an
4 administrative priority, it does not do so.

5 Accordingly, the Trustee's objection is sustained, and A+B's request for an
6 administrative expense claim for fees and services provided to HLC during the period it was
7 in Chapter 11 is denied. A+B is required to turnover to the Trustee the remaining balance of
8 its retainer as of the petition date. A+B's request for an administrative claim of \$331.95 for
9 expenses incurred post-conversion is allowed.

END OF ORDER

UNITED STATES BANKRUPTCY COURT
for the Northern District of California

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COURT SERVICE LIST

2 All ECF Recipients

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